

IN THE
United States Court of Appeals
For the Ninth Circuit

IRMGARD SANTOS, *Petitioner*

v.

COMMISSIONER OF INTERNAL REVENUE, *Respondent*

On Petition for Review of the Decision of the Tax Court of
the United States

BRIEF FOR THE RESPONDENT

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BRIEF FOR THE RESPONDENT

OPINION BELOW

The findings of fact and opinion of the Tax Court (R. 46-65) are reported in 26 T.C. No. 71.

JURISDICTION

This review (R. 66-69) involves the transferee liability of taxpayer, Irmgard Santos,* for the income

* The petitioner-transferee will be referred to as taxpayer throughout.

taxes of her husband, Lawrence Santos, transferor, for the taxable years 1943 to 1946, inclusive. On October 15, 1952, the Commissioner of Internal Revenue sent a deficiency notice to taxpayer as transferee of her husband, asserting a liability of \$68,287.90 representing a portion of his unpaid taxes for the years indicated. (R. 3.) On January 8, 1953, taxpayer filed a petition with the Tax Court for redetermination of the deficiency under the provisions of Section 272(a) of the Internal Revenue Code of 1939. Decision of the Tax Court was entered June 18, 1956. (R. 65-66.) Petition for review by this Court was filed September 7, 1956. (R. 66-69.) Jurisdiction is conferred on this Court by Section 7482 of the Internal Revenue Code of 1954.

QUESTION PRESENTED

Whether the Tax Court correctly sustained the determination of the Commissioner of Internal Revenue that there was a transfer of the separate property of taxpayer's husband to taxpayer during periods when he was at all times insolvent so as to make taxpayer liable as a transferee under Section 311 of the Internal Revenue Code.

STATUTES AND REGULATIONS INVOLVED

The pertinent provisions of the statutes and Regulations involved are set forth in the Appendix, *infra*.

STATEMENT

The facts as found by the Tax Court (R. 47-56) based on oral testimony (R. 71-174), exhibit (R. 174-200) and stipulations of the parties (R. 33-45) are stated below.

Taxpayer is a resident of the City of Honolulu, Territory of Hawaii. In 1928 she was married to Lawrence Santos of Honolulu. (R. 47.)

On October 15, 1952, the Commissioner mailed taxpayer, as transferee of assets of Lawrence Santos, a notice of deficiency in the amount of \$68,287.90. (R. 47.)

At the time taxpayer married Lawrence Santos they were both employed. Taxpayer was receiving a salary of \$125 a month, which was later increased to \$165 a month. Lawrence Santos was receiving a salary of \$175 a month, which was increased to \$200 a month. When Lawrence Santos started Persans, Limited, he had no assets other than the salaries of himself and wife. (R. 47.)

In 1937 Persans, Limited, a Hawaii corporation, was organized to engage in the retail shoe business in Honolulu. It was capitalized at \$20,000 and stock of the par value of \$5,000 was issued to Lawrence Santos, and dividends were paid to him individually; the balance of the outstanding stock of \$15,000 was issued to others. Lawrence Santos obtained the \$5,000 with which he acquired his shares by a loan from his uncle on a promissory note signed by Lawrence Santos and taxpayer, secured by a jointly executed mortgage on a house located on Oahu Avenue, Manoa Valley, Honolulu, owned by Lawrence Santos and taxpayer as joint tenants. This \$5,000 loan was repaid by Lawrence out of his joint checking account. (R. 48.)

Lawrence worked full time for Persans, Limited, and received a salary. Taxpayer worked at Persans on Saturdays and other days after she had completed her regular job, receiving no salary for such work. Lawrence gradually acquired, through purchase or

inheritance, all of the stock of Persans, Limited. (R. 47-48.)

In May, 1942, Lawrence purchased Manufacturers' Shoe Store in Honolulu for \$50,000. In December, 1942, he liquidated Persans, Limited, and the proceeds were paid to Lawrence Santos, doing business as an individual proprietor of Manufacturers' Shoe Store. (R. 48-49.)

On July 1, 1944, Lawrence Santos created an irrevocable trust by transfer to Hawaiian Trust Company, Limited, of the sum of \$70,000, the beneficiaries of the trust being the two children of Lawrence Santos and taxpayer. A limited partnership was organized in accordance with the laws of the Territory of Hawaii by and between Lawrence Santos, as general partner, and Hawaiian Trust Company, Limited, Trustee, under Deed of Trust dated July 1, 1944, as limited partner, for the purpose of acquiring at the close of business on June 30, 1944, all the assets of, and to carry on the business heretofore carried on and conducted by, Lawrence Santos under the name of Manufacturers' Shoe Store, in accordance with a limited partnership agreement between Lawrence Santos and Hawaiian Trust Company, Limited, dated as of July 1, 1944. Lawrence Santos transferred to such limited partnership all of his right, title, and interest in the assets of the business formerly carried on by him under the name of Manufacturers' Shoe Store, having a net book value of \$105,000, in exchange for a 60 per cent interest in such limited partnership, and Hawaiian Trust Company, Limited, as trustee, at the same time contributed the sum of \$70,000 and acquired ownership of a 40 per cent interest in such partnership. At the time of the creation of the limited part-

nership no share therein was given to taxpayer in recognition of any interest she might have or claim in the business formerly carried on as Manufacturers' Shoe Store or in the business of Persans, Limited. (R. 49-50.)

Effective June 1, 1945, the Territory of Hawaii adopted a community property law providing in part that all property, including earnings of the husband and wife, and rents, issues, income, and other profits of the separate property of the husband or wife acquired after marriage or the effective date of the act, whichever was later, shall be the community property of the husband and wife. Revised Laws of Hawaii 1945, c. 301A. This community property law was repealed effective June 30, 1949. Session Laws of Hawaii 1949, c. 301A. (R. 50.)

On March 1, 1947, Manufacturers' Shoe Company, Limited, was incorporated to take over the assets and liabilities of the limited partnership. The corporation was capitalized at \$350,000, Lawrence Santos receiving capital stock of the par value of \$210,000, and Hawaiian Trust Company, Limited, as trustee, receiving capital stock of the par value of \$140,000. (R. 50.)

In the early part of 1948 Lawrence Santos requested Cameron and Johnstone, auditors for the corporation and for the limited partnership, to determine what portion of the capital stock of \$210,000 issued to him at incorporation of Manufacturers' Shoe Company, Limited, represented earnings since June 1, 1945, i.e., that portion which represented community property. Cameron and Johnstone made an examination, and on April 5, 1958, advised Lawrence Santos that \$105,000 out of the \$210,000 was community property and that

his wife would be entitled to receive stock of the par value of \$52,500 in recognition of her community property interest in the earnings of the business from June 1, 1945, to February 28, 1947. On or about April 5, 1948, Lawrence Santos then transferred to taxpayer, as of March 1, 1947, capital stock of Manufacturers' Shoe Company of the par value of \$52,500 out of his share of the capital stock of the company, leaving him stock of the par value of \$157,500. (R. 50-51.)

From August, 1951, to June, 1952, taxpayer lived on the West Coast. She returned to Honolulu in June, 1952, and stayed until August, 1952, when she finally moved to California. In October, 1952, she filed an action in a California court for separate maintenance. Personal service, however, was never obtained on Lawrence Santos in such action. In December, 1953, she returned to Honolulu, where she is now living. (R. 51.)

Taxpayer's share of the community income of herself and Lawrence Santos for the period from June 1, 1945 (commencement of community property), to February 28, 1947 (the date of the organization of the corporation), was as follows (R. 51-52):

June 1, 1945 - December 31, 1945.....	\$ 15,621.92
January 1, 1946 - December 31, 1946..	54,400.31
January 1, 1947 - February 28, 1947...	41,564.78

Total	\$111,587.01
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Taxpayer's share of the community income of herself and husband for the period from March 1, 1947, to July 1, 1949 (the end of community property), was as follows (R. 52):

March 1, 1947 - December 31, 1947....	\$ 11,610.60
January 1, 1948 - December 31, 1948..	21,063.38
January 1, 1949 - June 30, 1949.....	10,715.52
Total	<u>\$ 43,389.50</u>

Taxpayer's federal income tax liability on her community income as aforesaid for the taxable years 1945, 1946, 1947, 1948, and 1949 was \$5,240.96, \$28,257.97, \$27,384.49, \$6,165.16 and \$3,241.33, respectively. (R. 52.)

Taxpayer's aggregate community income during the community property period, after federal income tax liability, was \$84,686.60. (R. 52.)

Lawrence Santos purchased from Bishop National Bank cashier's checks payable to Lawrence Santos and/or Irmgard Santos, on the dates and in the amounts as follows (R. 52):

Date	Amount
April 15, 1948.....	\$ 14,000.00
April 16, 1948.....	12,328.80
November 16, 1948.....	15,000.00
May 13, 1949.....	10,718.77
May 16, 1949.....	13,547.14
August 8, 1950.....	10,448.84
September 18, 1950.....	6,229.12
Total	<u>\$ 82,272.67</u>

Lawrence gave the cashier's checks to taxpayer who retained them. In November, 1950, Lawrence went to California, and on November 22, 1950, he received the checks from taxpayer; Lawrence alone endorsed them and purchased \$80,000 principal amount of United States Treasury 2-1/2 per cent bearer bonds for the

total price of \$81,674.32. On November 27, 1950, Lawrence took delivery of the bonds and gave his receipt therefor. Lawrence delivered the United States Treasury bonds to taxpayer who retained them until sold. One \$10,000 bond was sold on April 1, 1952, and the proceeds were used to pay the joint territorial taxes of taxpayer and her husband. (R. 53.)

On March 27, 1952, taxpayer sold the bonds in the principal amount of \$70,000 for the total amount of \$68,287.90, and received checks in that amount payable to her order. Taxpayer endorsed the checks in favor of Smith, Wild, Beebe and Cades, of Honolulu, who deposited them in a trust account and then made a check payable to the Collector of Internal Revenue in the amount of \$68,287.90 in payment of the individual taxes asserted against taxpayer for the taxable years 1943 to 1947, inclusive, in the jeopardy assessments which had been levied against her. On April 4, 1952, a certificate of discharge of tax liens against taxpayer for the years 1943 to 1947, inclusive, was issued by the Collector of Internal Revenue and duly recorded. (R. 53.)

In the subsequent and final determination of taxpayer's individual income tax liabilities for the years 1943 to 1947, inclusive, which were at issue before the Tax Court of the United States in docket No. 42682 (not reported), it was determined that taxpayer had overpaid her income tax liabilities for the years 1945 and 1946 in the amounts of \$24,768.51 and \$38,237.18, respectively. (R. 53-54.)

The Manufacturers' Shoe Company, Limited, from the time of its incorporation on March 1, 1947, through the taxable year 1952, declared and paid dividends in each of the fiscal years ended February 28, 1949, and

February 28, 1951, in the amount of \$8,750. Taxpayer's pro rata share of the 1949 dividend from her aforesaid stockholdings in the corporation is included in the amount of her community income hereinabove set forth. (R. 54.)

The total value of the assets of Lawrence Santos as of December 31 of each of the following years was in the amount for each of such years as follows (R. 54):

Year	Amount
December 31, 1947.....	\$214,640.60
December 31, 1948.....	205,813.93
December 31, 1949.....	215,372.66
December 31, 1950.....	236,843.73
December 31, 1951.....	237,302.02
December 31, 1952.....	213,452.24

On December 26, 1951, the first assessment was made against Lawrence Santos with respect to federal income tax deficiencies for the years 1943, 1944, 1945, and 1946. An additional assessment was made on February 27, 1952. The unpaid liability of Lawrence Santos for federal income taxes and penalties, incurred but not assessed, at December 31 of the years 1948, 1949, 1950, 1951, and 1952, was \$415,427.73, plus interest. In addition to the aforesaid federal tax liabilities Lawrence Santos, as of December 31 of each of the years 1948, 1949, 1950, 1951, and 1952, was indebted to the Manufacturers' Shoe Store in the amounts of \$91,651.69, \$105,856.50, \$120,404.73, \$127,308.70, and \$127,511.70, respectively. (R. 54-55.)

For 1952 taxpayer and her husband filed separate income tax returns. Lawrence Santos claimed a loss on his return in the amount of \$4,244.94 incurred on

the sale in that year of the \$80,000 United States Treasury bonds here in question. Taxpayer reported no such transaction or loss on her individual returns although her attorney, who prepared her return, had knowledge that the bonds had been sold. On April 5, 1954, taxpayer filed a joint return for the year 1952. (R. 55.)

On April 4, 1950, the house at Halelea Place, Manoa Valley, Honolulu, owned by taxpayer and Lawrence Santos as joint tenants, was sold for \$21,000. After deduction of \$1,085.10 expenses, net proceeds were \$19,914.90. The Halelea Place house was purchased on September 23, 1941, for \$14,250, utilizing proceeds from the sale of the house on Oahu Avenue which had been owned by them as joint tenants and which had been sold on March 12, 1941. The Oahu Avenue house was purchased on July 26, 1937, utilizing proceeds from the sale of a house on Liliha Street, Honolulu, owned by the taxpayer and her husband as joint tenants. (R. 55-56.)

The Santos family consisted of taxpayer, her husband, and their two minor children. They maintained a home with over \$50,000 worth of furniture in it, and they operated three late-model automobiles. The family was maintained in a manner and style commensurate with the community income. (R. 56.)

During the period December 31, 1947, to December 31, 1952, Lawrence Santos was insolvent. (R. 56.)

The Tax Court also found as a fact the disputed matter on this appeal, namely, that during the period April 15, 1948, to March 27, 1952, Lawrence Santos gratuitously transferred to taxpayer his separate property having a value of at least \$68,287.90, and

that taxpayer is liable as transferee under Section 311 of the Internal Revenue Code to that extent. (R. 56.)

SUMMARY OF ARGUMENT

Over a period of three years taxpayer's husband transferred certain assets to her, and the Commissioner asserted transferee liability because of these transfers. The only matter in contention is whether this represented a transfer of the separate property of the husband, or whether the operation of a community property statute enacted in Hawaii where the taxpayer and her husband lived vested taxpayer with an interest in the assets by operation of law.

It is Commissioner's position that the Tax Court was correct in finding that any community arising under this law was exhausted in the maintenance of the family. Consequently, any transfers to taxpayer must have been from the separate property of her husband, thus subjecting her to transferee liability.

While the Commissioner has been allocated the burden of proof in transferee cases, that burden was met in this case by showing the transfers were made while the transferor was insolvent and by showing facts from which it can be inferred that no community existed.

Even if the Tax Court's reasoning that the community was exhausted be rejected, the Hawaiian statute itself imposed upon the earnings of the husband and income from his separate property during the existence of the community liability for federal income taxes incurred before the effective date of the Act. Taxpayer received such assets subject to the paramount right of the Government and accordingly

was liable "at law" as a transferee under Section 311 of the 1939 Code.

Finally, even if the assets be viewed as community property, the community under Hawaiian law was subject to the payment of all debts incurred in the production of community income and the Government's right to reach community property for taxes incurred after the effective date of the Act cannot be circumvented by transfers to taxpayer. In such a situation she sustained transferee liability "at law" under Section 311 of the 1939 Code.

ARGUMENT

The Tax Court Correctly Held That There Was a Transfer of the Separate Property of Taxpayer's Husband to Taxpayer During Periods When He Was at All Times Insolvent So as to Make Taxpayer Liable as a Transferee Under Section 311 of the Internal Revenue Code of 1939

The Tax Court found that over a period of three years beginning April 15, 1948 and ending September 18, 1950, taxpayer's husband, Lawrence Santos, purchased cashier's checks of the value of \$82,272.67 in the name of himself and taxpayer, and delivered these checks to the taxpayer. (R. 52-53.) On November 22, 1950, taxpayer returned the checks to her husband who, upon her request (R. 123), purchased \$80,000 face amount United States Treasury bearer bonds for the total price of \$81,674.32 and delivered them to taxpayer (R. 53). Further tracing of these funds revealed that on April 1, 1952 one \$10,000 bond was sold and the proceeds used to pay the joint territorial taxes of taxpayer and her husband. The remaining \$70,000 in bonds were later sold by taxpayer for \$68,287.90 and this amount was used to discharge her individual income tax liability for the years 1943 to 1947. (R. 53.)

Subsequently, in another proceeding in the Tax Court (Docket No. 42682, not reported) in which taxpayer's individual income tax liabilities for 1943 to 1947 were finally determined, it was stipulated that this was an overpayment of \$24,768.51 and \$38,237.18 for the years 1945 and 1946. (R. 54; Ex. 1A to Stip., R. 43.)

The undisputed facts further show that taxpayer's husband was insolvent at all times when such transfers were made because of federal income tax liability. (R. 40-41, 45, 56.)

Unquestionably, these facts without more would result in transferee liability. There was a transfer made while the transferor was insolvent and without consideration. However, in this case such liability is resisted on the grounds that the enactment of a community property law in Hawaii that was in force during part of the period when such transfers were made prevents this liability. The fallacies of this approach were dealt with in the Tax Court opinion (R. 56-65) and consequently will be elaborated here only briefly.

The Hawaiian community property statute became effective June 1, 1945, and remained in effect until June 30, 1949. (Material portions of this Act are set out in Appendix, *infra*.) The Act provided that all property separately owned at the effective date of the Act or the date of marriage, whichever was later, would continue as separate property. Also, it provided that earnings of the spouses, and all the rents, issues, incomes and other profits of the separate property of each shall be community property. Sections 1, 2 and 4, Revised Laws of Hawaii (1945), c. 301A, Appendix, *infra*; see also *McKay v. Commissioner*, 24 T.C. 86, construing these provisions.

At the effective date of the Act, June 1, 1945, taxpayer's husband owned 60 per cent of a limited partnership which had been formed on July 1, 1944, to carry on the business theretofore conducted by the husband since 1942 under the name of Manufacturers' Shoe Store. (R. 48-50.) In 1947 the business was incorporated and continued as a corporation throughout the community property period. (R. 50.) The earnings from this business constitute all of the community under discussion. Taxpayer's share of this community for the entire period during which the community property statute was effective was found to be \$154,976.51, and her federal income tax liability was \$70,289.91. (R. 38, 52.) From these undisputed facts the deductions of the Tax Court proceed as logically as simple mathematics. If taxpayer's share was \$154,976.51 the entire community was twice that amount or \$309,953.02. Deducting from this figure the aggregate federal income tax liability of \$140,579.82 and the \$105,000 commuted to the separate property of each spouse in 1948 (R. 50-51) the Tax Court found a total remaining community for the entire period of \$64,373.20 (R. 57-58).

The settled presumption, in the absence of contrary evidence, is that community expenses are paid from community property. *Huber v. Huber*, 27 Cal. 2d 784, 167 P. 2d 708; *In re Tomkins Estate*, 123 Cal. App. 670, 11 P. 2d 886; *Van Camp v. Van Camp*, 53 Cal. App. 17, 199 Pac. 885; *In re Cudworth's Estate*, 133 Cal. 462, 65 Pac. 1041; *Tinling v. Commissioner*, 7 T.C. 1393; *Van Vorst v. Commissioner*, 7 T.C. 826; *Oliver v. Commissioner*, 4 T.C. 684. The Tax Court applied this presumption because it nowhere appeared in the record from what funds community expenses were

taken, and the Hawaiian law expressly allowed community funds to be so used. Section 13(h), Revised Laws of Hawaii, 1945. (Appendix, *infra*.)

As to how much of the community was thus expended, the Tax Court carefully examined the material evidence and found inferentially at least, that the entire community was so exhausted, saying (R. 59):

The evidence shows that the Santos family consisted of taxpayer, her husband, and two minor children, and that they lived in a style and manner commensurate with their income. The Santos family lived in a home with over \$50,000 worth of furniture and operated three late-model automobiles. Their tax returns, which are in evidence, show that during the community period approximately \$9,000 was paid for Territorial income taxes.

The logic of the Tax Court's approach can scarcely be controverted. Only two types of property were recognized under the Hawaiian statute, separate and community. (c. 301A, Sections 1, 2, 4, Revised Laws of Hawaii (1945)). After demonstrating that the entire community was presumptively exhausted, it necessarily follows that any transfers to the taxpayer by her husband were from his separate property. As his separate property it was subject to payment of his taxes. In the hands of his wife it could be reached for his taxes through the transferee provisions in Section 311 of the Internal Revenue Code of 1939. (Appendix, *infra*.) Indeed, the original enactment of the substance of this section in the Revenue Act of 1926, c. 27, 44 Stat. 9, Section 280(a)(1), was designed *inter alia* to aid collection in the situation where "A husband may make a gift of the whole or part of his property to his wife." (S. Rep. No. 52, 69th Cong.,

1st Sess., p. 29 (1926) (1939-1 Cum. Bull. (Part 2) 332, 354; H. Conference Rep. No. 356, 69th Cong., 1st Sess., p. 43 (1926) (1939-1 Cum. Bull. (Part 2) 361, 371.)

Taxpayer's contention (Br. 9) that the \$82,272.67 given to her in 1948, 1949 and 1950 was her own share of community property is obviously erroneous. The Tax Court clearly demonstrated that there was only \$64,373.20 remaining in the community after part had been reduced to separate property and federal income taxes deducted from the remainder. (R. 57-58.) To contend that the \$82,272.67 is taxpayer's share of what was left of \$64,373.20 after payment of community expenses is contrary to facts proved with mathematical certainty. Some of the community property must have been used for community expenses which because of the style and manner of the Santos'es' living was demonstrated to be large and taxpayer was entitled to only one-half of whatever remained. After weighing the facts the Tax Court found that, presumptively, nothing remained in the community. (R. 59.) Unless this can be viewed as "clearly erroneous" it should not be disturbed on appeal. Rule 52(a), Federal Rules of Civil Procedure.

While it is true that the Commissioner has the burden of proof in transferee cases by the operation of Section 1119 of the 1939 Code, this burden was clearly met in the instant case. The burden thus placed on the Commissioner has been defined and the quantum of evidence necessary to satisfy it has been described by the courts.

In *Noell v. Commissioner*, 22 T.C. 1035, the transferee objected that the Commissioner had not proved insolvency. The Tax Court there said (p. 1042):

Although the burden of proof in transferee cases is on the respondent, the burden of going forward with the evidence is shifted to the petitioner *upon proof of gratuitous transfers*. * * * Such transfers having been admittedly made in the instant case, a prima facie case of transferee liability was established and petitioner had the burden of showing Noell's solvency. (Emphasis supplied.)

In *Robinette v. Commissioner*, 139 F. 2d 285 (C.A. 6th), the court held a prima facie case had been made by proving receipt of assets in excess of that transferor's tax liability. To the same effect see *Gobins v. Commissioner*, 18 T.C. 1159, affirmed by this Court, 217 F. 2d 952, and *Hutton v. Commissioner*, 59 F. 2d 66 (C.A. 9th).

The instant case reveals a similar situation. By stipulated facts, documents and oral testimony it was established that there had been in excess of \$80,000 transferred to taxpayer. (R. 53.) The facts reveal that no consideration was given for such transfers, and that the transferor had at all material times been insolvent. (R. 52-55.) The only real question was whether the amounts transferred were community property or the separate property of the husband. On this issue, based on sound legal presumptions and logical inferences, the facts support the conclusion that there was no community available from which the transfers could have been made.

Even if the Tax Court's reasoning that the community was exhausted by the expenses of maintaining the family be rejected, its decision is still supportable on the express language of the Hawaiian statute.

Section 13(f) of the statute (Appendix, *infra*,) provides:

The earnings of the husband and the rents, issues, incomes and other profits of the separate property of the husband shall be liable for debts contracted by the husband prior to the inception of the community and the liabilities of the husband arising prior to the inception of the community out of tort or otherwise,

On June 1, 1945, the effective date of the Hawaiian statute, as shown by the letter accompanying the deficiency notice sent taxpayer (R. 5) Lawrence Santos had incurred income tax liabilities for 1943 and 1944 of \$177,847.27 and \$163,935.11. Under the express language of the statute it would appear that any subsequent earnings or income from the separate property of Lawrence Santos would be subject to this liability. Mr. Santos testified that most of the money given to taxpayer came from his salary and bonuses from his business. (R. 114). In view of these facts taxpayer took the money subject to the paramount claim of the Government under Hawaiian law and her transferee liability "at law" within the meaning of Section 311(a) of the 1939 Code was thus established.

That the taxes were not assessed until 1951 (R. 54) is of little consequence. Taxes incurred but not assessed are regarded as debts for the purpose of computing the insolvency of a transferor, and, it is submitted that the same rationale applies in determining pre-community debts under the Hawaiian statute. See *Scott v. Commissioner*, 117 F. 2d 36 (C.A. 8th); *Buzard v. Helvering*, 77 F. 2d 391 (C.A. D.C.); *Rubel v. Commissioner*, 74 F. 2d 27 (C.A. 6th).

Even assuming, arguendo, that the payments were made to taxpayer from the profits of her husband's business, and that such profits became community property and were not exhausted by community expenses, it is the Commissioner's position that transferee liability would still attach.

Part of Lawrence Santos' income tax liability for which taxpayer is being held as a transferee was for community property years. The deficiency letter (R. 5) indicates that for the years 1945 and 1946 taxpayer's husband's tax liabilities were \$105,588.98 and \$28,693.58, respectively. The inception of the Santos community was the effective date of the Act, June 1, 1945. Adding roughly one-half of the 1945 liability and all of the 1946 liability it is obvious that an amount far in excess of the asserted transferee liability of \$68,287.90 was incurred as an income tax liability during the community property years.

Under the express provisions of the Hawaiian statute (Section 13(c), Appendix, *infra*) community property is subject to the payment of debts and liabilities relating to the management, control, disposition of or other dealing with or for the benefit or protection of the community. This places Hawaii in accord with most community property states in holding that liabilities incurred in the production of income for the community are payable from community property. Indeed, it is the very essence of the community property system that community debts are payable from community property. See e.g. *Mauldin v. Mauldin*, 275 P. 2d 113 (Cal. App.); *Farmers Exchange National Bank v. Drew*, 48 Cal. App. 442, 192 Pac. 105; *Hearron v. Severyns*, 159 Wash. 486, 293 Pac. 458; *Strong v. Eakin*, 11 N.M. 107, 66 Pac. 539.

Thus, under the Hawaiian statute and the general rule the income taxes incurred by Lawrence Santos during community property years were debts of the community, and all the assets of the community were subject to its payment. It is only logical that if, as in the instant case, community property thus burdened were transferred to the separate property of one spouse that transferee liability should result "at law" under Section 311 of the 1939 Code.

Summarizing, it is the Commissioner's position on this appeal that the Tax Court's determination that there was no community is correct. Even if the Tax Court's method of reaching its conclusion is rejected, the same result follows under the Hawaiian statute, and even assuming that the transfer in question constituted a conveyance of community property, the liability of taxpayer as a transferee is nonetheless established.

CONCLUSION

For the reasons above, the decision of the Tax Court is correct and should be affirmed.

Respectfully submitted,

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APPENDIX

Internal Revenue Code of 1939:

SEC. 311. TRANSFERRED ASSETS.

(a) *Method of Collection.*—The amounts of the following liabilities shall, except as hereinafter in this section provided, be assessed, collected, and paid in the same manner and subject to the same provisions and limitations as in the case of a deficiency in a tax imposed by this chapter (including the provisions in case of delinquency in payment after notice and demand, the provisions authorizing distraint and proceedings in court for collection and the provisions prohibiting claims and suits for refunds):

(1) *Transferees.*—The liability, at law or in equity, of a transferee of property of a taxpayer, in respect of the tax (including interest, additional amounts, and additions to the tax provided by law) imposed upon the taxpayer by this chapter.

* * * *

Any such liability may be either as to the amount of tax shown on the return or as to any deficiency in tax.

* * * *

(26 U.S.C. 1952 ed., Sec. 311.)

Treasury Regulations 111, promulgated under the Internal Revenue Code of 1939:

Sec. 29.311-1. *Claims in Cases of Transferred Assets.*—The amount for which a transferee of the property of a taxpayer is liable, at law or in equity * * * whether shown on the return of the taxpayer or determined as a deficiency in the tax, shall be assessed against such transferee * * * and collected and paid in the same manner and

subject to the same provisions and limitations as in the case of a deficiency in a tax imposed by chapter 1, except as hereinafter provided. The provisions relating to delinquency in payment after notice and demand and the amount of interest attaching because of such delinquency, the authorization of distraint and proceedings in court for collection, the prohibition of claims for abatement and claims and suits for refund, the filing of a petition with The Tax Court of the United States, and the filing of a petition for review of The Tax Court's decision, are included in the sections of the Internal Revenue Code (and regulations pertaining thereto) relating to deficiencies in tax imposed by chapter 1.

The term "transferee" as used in this section includes an heir, legatee, devisee, distributee of an estate of a deceased person, the shareholder of a dissolved corporation, the assignee or donee of an insolvent person, the successor of a corporation, a party to a reorganization as defined in section 112, and all other classes of distributees.

* * * *

Revised Law of Hawaii (1945):

Chapter 301A [as added by Act 273, Session Laws of Hawaii (1945)]. COMMUNITY PROPERTY.

Sec. 1. *Separate property of husband.* All property, both real and personal of the husband owned by him before marriage or before the effective date of this chapter, whichever is the later, and all property acquired by the husband thereafter by gift, devise, bequest or descent, and also all substitutions for any such property made at any time or from time to time, by sale or exchange or other disposition or by investment or otherwise, shall be his separate property.

Sec. 2. *Separate property of wife.* All property, both real and personal, of the wife owned by her before marriage or before the effective date of this chapter, whichever is the later, and all property acquired by the wife thereafter by gift, devise, bequest or descent, and also all substitutions for any such property made at any time or from time to time, by sale or exchange or other disposition or by investment or otherwise, shall be her separate property.

* * * *

Sec. 4. *Community property.* Except as otherwise provided in this chapter, all property, both real and personal, including earnings of the husband and earnings of the wife and including rents, issues, income and other profits of the separate property of the husband and rents, issues, income and other profits of the separate property of the wife, acquired by the husband or by the wife after marriage or on or after the effective date of this chapter, whichever is the later, shall be community property of the husband and wife, and each shall be vested with an undivided one-half interest therein. The respective interests of the husband and the wife in such community property shall be present, existing and equal interests. The respective interests of the husband and the wife in such community property shall arise as an incident of marriage.

Sec. 5. *Presumption of community property.* There shall be a rebuttable presumption that all property, both real and personal, acquired by the husband or by the wife after marriage or on or after the effective date of this chapter, whichever is the later, is community property.

Sec. 6. *Ownership of property by husband and wife.* A husband and wife may hold property as joint tenants, as tenants in common, as tenants by

the entirety, or as community property. There shall be a rebuttable presumption that all property, both real and personal, acquired by the husband and the wife after marriage or on or after the effective date of this chapter, whichever is the later, is community property, unless a different intention is expressed in the instrument by which the property is acquired.

Sec. 7. *Transfers—husband to wife and wife to husband.* The husband may give, grant, bargain, sell or convey directly to his wife, and the wife may give, grant, bargain, sell or convey directly to her husband, his or her community right, title, interest or estate in all or any community property, real or personal. Every such transfer made from the husband to the wife or from the wife to the husband shall operate to divest the property therein described of every claim or demand as community property, and shall vest the same in the transferee as the separate property of the transferee; *provided*, however, that no such transfer shall affect any equity in favor of creditors at the time of such transfer.

Sec. 8. *Control of husband's separate property.* The husband shall have the same right to manage, control, dispose of, and otherwise deal with his separate property as would be applicable with respect to his property generally were it not for the enactment of this chapter.

Sec. 9. *Control of wife's separate property.* The wife shall have the same right to manage, control, dispose of, and otherwise deal with her separate property as would be applicable with respect to her property generally were it not for the enactment of this chapter.

Sec. 10. *Control of community property.* The wife as agent for the community shall have the

same right as though it were her separate property to receive, manage, control, dispose of and otherwise deal with that portion of the community property which consists of her earnings, the rents, issues, income and other profits of her separate property and all other community property which shall stand in her name, subject to the limitations below listed. The husband as agent for the community shall have the same right as though it were his separate property to receive, manage, control, dispose of and otherwise deal with all other community property, including that portion of the community property which consists of his earnings, the rents, issues, income and other profits of his separate property and all other community property which shall stand in his name, subject to the limitations below listed. The limitations herein referred to are as follows: (1) Neither the husband nor the wife shall dispose of or encumber community real property or lease community real property for a longer period than one year unless the other shall join in the execution of the instrument. (2) Neither the husband nor the wife shall make any gift of community property or dispose of or encumber the same without a valuable consideration, without the consent of the other. (3) Neither the husband nor the wife shall dispose of or encumber the furniture, furnishings or fittings of the home, to the extent that the same constitute community property, without the consent of the other. (4) Neither the husband nor the wife shall have the right to devise or bequeath more than one-half of the community property. (5) The rights given to the husband and to the wife to manage, control, dispose of and otherwise deal with community property, as provided in this section, shall be exercised in good faith for the benefit of the community. In case of any violation by the husband or the wife of the above limitations

or any thereof, the person aggrieved shall be entitled to appropriate relief at law or in equity, according to the nature of the relief sought, and for such purpose the wife may sue or be sued by her husband in her own name and without the interposition of a next friend. The foregoing provisions shall not entitle the wife or the husband, by court proceedings or otherwise, to interfere with or affect the right of the other to collect his or her earnings or the rents, issues, income and other profits of his or her separate property.

* * * *

Sec. 13. Property subject to obligations. (a) The separate property of the wife shall be liable for debts contracted at any time by the wife and liabilities of the wife arising at any time out of tort or otherwise, including any such debts or liabilities by reason of any transaction entered into or action taken by the wife relating to the management or control or disposition of or other dealing with or for the protection or benefit of the community property, but shall not be liable for debts or liabilities of the husband.

(b) The separate property of the husband shall be liable for debts contracted at any time by the husband and liabilities of the husband arising at any time out of tort or otherwise, including any such debts or liabilities by reason of any transaction entered into or action taken by the husband relating to the management or control or disposition of or other dealing with or for the protection or benefit of the community property, but shall not be liable for debts or liabilities of the wife.

(c) The community property shall be liable for debts contracted by the husband or by the wife or by both, and for liabilities of the husband or the wife or both arising out of tort or otherwise, in any transaction entered into or action taken by

the husband or the wife or both relating to the management or control or disposition of or other dealing with or for the protection or benefit of the community property. With respect to the liability of community property for such debts and liabilities, no distinction shall be made between community property subject to the management and control of the wife and community property subject to the management and control of the husband.

(d) As between the community property and the separate property of the wife or of the husband the community property shall be liable for the debts and liabilities referred to in paragraph (c) of this section.

(e) The earnings of the wife and the rents, issues, incomes and other profits of the separate property of the wife shall be liable for debts contracted by the wife prior to the inception of the community and the liabilities of the wife arising prior to the inception of the community out of tort or otherwise.

(f) The earnings of the husband and the rents, issues, incomes and other profits of the separate property of the husband shall be liable for debts contracted by the husband prior to the inception of the community and the liabilities of the husband arising prior to the inception of the community out of tort or otherwise.

(g) As between the community property and the separate property of the wife or of the husband, the separate property shall be liable for the debts and liabilities referred to in paragraphs (e) and (f) of this section. For the purposes of said paragraphs (e) and (f) the inception of the community shall be the marriage of the husband and wife or the effective date of this chapter, whichever is the later.

(h) Nothing in this section shall be deemed to affect or modify the obligation of the husband to support his wife and family and to discharge all debts contracted by the wife for necessities for herself and family during marriage; *provided*, however, that if and whenever there is community property available for such purpose the husband shall be entitled to resort to such community property rather than to his separate property.

(i) Nothing in this section shall be deemed to prevent the wife or the husband from mortgaging or pledging her or his separate property or to prevent the wife and the husband from joining in a mortgage or pledge of community property as security for any indebtedness whether of the wife or of the husband or both.

Sec. 14. *Divorce—division of property.* In the event of the dissolution of marriage by decree of any court of competent jurisdiction, community property shall be divided between the parties by the court granting the decree, in such proportions as such court, from the facts in the case, shall deem just and equitable, and such division shall be subject to revision on appeal in all respects including the exercise of discretion by the court below.

* * * *

Sec. 16. *Prospective application only.* This chapter shall not be construed to operate retroactively and any right established or accrued and any action taken prior to the effective date of this chapter shall be governed by the law in force at the time such right was established or accrued or such action was taken.

* * * *

Sec. 18. *Effective date.* The effective date of this chapter shall be the first day of the first month following the month in which the act enacting this chapter is approved.

Session Laws of Hawaii 1949:

Chapter 301A. COMMUNITY PROPERTY.

Section 1. Sections 1, 2, 3, 4 and 6 of chapter 301A of the Revised Laws of Hawaii 1945, as enacted by Act 273 of the Session Laws of Hawaii 1945, are hereby repealed. Such repeal shall not operate to divest any interest in property which was acquired, established, accrued or vested prior to the effective date of this Act. Except as otherwise provided in this Act, any right established or accrued and any action taken prior to the effective date of this Act shall be governed by the law in force at the time such right was established or accrued or such action was taken.

Section 2. Every marital community existing pursuant to said *Chapter 301A* of the Revised Laws of Hawaii 1945 is hereby dissolved. Unless and until the property shall be transferred or converted into separate property, any property which is now held as community property pursuant to said chapter 301A, and the rents, issues, income and other profits thereof and all substitutions therefor, shall be held as community property and shall be governed by the provisions of said chapter 301A, as amended, subject to any disposition thereof pursuant to the provisions of said chapter 301A, as amended.

* * * *

Section 4. This Act shall take effect at midnight on June 30, 1949; * * *

